U.S. BANKRUPTCY COURT
District of South Carolina

Case Number: **10-06335-jw**
Adversary Proceeding Number: **12-80208-jw**

Order Granting in Part and Denying in Part MK Defendants' Motion for Summary Judgment

The relief set forth on the following pages, for a total of 41 pages including this page, is hereby ORDERED.

FILED BY THE COURT
12/22/2016

Entered: 12/22/2016

US Bankruptcy Judge
District of South Carolina

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

In re Infinity Business Group, Inc., Debtor.	C/A No. 10-06335-JW Adv. Pro. No. 12-80208-JW Chapter 7
Robert F Anderson, as Chapter 7 Trustee, Plaintiff, v. Keith E. Meyers, Cordell L.L.C, The Cordell Group L.L.C, Gibson Commons L.L.C, Bryon K Sturgill, John F Blevins, Golden Ghost, Inc., Haines H. Hargrett, Donald Brent Grafton, D. Larry Grafton, Grafton and Company, P.L.L.C., Morgan Keegan & Company, Inc., Law Offices of John F. Blevins, LLC, O. Bradshaw Cordell, Wade Cordell, Sturgill & Associates Inc., Morgan Keegan & Associates, LLC, Defendants.	

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MORGAN KEEGAN & COMPANY, INC. AND KEITH E. MYERS MOTION FOR SUMMARY JUDGMENT

This matter comes before the Court on the motion of defendants Morgan Keegan & Company, Inc. ("MK") and Keith E. Myers (individually "Myers," collectively "MK Defendants") seeking summary judgment ("Motion") on the grounds that the Trustee's

remaining claims[1] are barred by the affirmative defenses of *in pari delicto* and/or by the running of the applicable statutes of limitation. The Trustee objected to the Motion.[2]

Having considered the arguments of counsel, as well as the pleadings and other submissions of the parties, the Court grants so much of the Motion as it relates to a portion of the Trustee's 30th Cause of Action (Breach of Contract – 2006 Contract), and the Trustee's 35th Cause of Action (Unjust Enrichment). Construing the remaining issues in a light most favorable to the Trustee, and resolving all inferences in his favor, the Court finds that the record contains questions of material fact that preclude the Court from granting the MK Defendants summary judgment on the balance of the Trustee's claims. Therefore, the Court denies the remainder of the Motion.

JURISDICTION

This Court has jurisdiction over this proceeding pursuant to 28 U.S.C. §§ 157 and 1334. This is a non-core proceeding under 28 U.S.C. § 157(b)(2), as it is "otherwise related to" the Chapter 7 bankruptcy case of Infinity Business Group, Inc. ("IBG" or "Debtor"). *See* 28 U.S.C. § 157(c)(1). Both the MK Defendants and the Trustee expressly consented on the record to this

[1] The Trustee's remaining claims against the MK Defendants are:

- Cause of Action #19: Rule 10b-5 violations;
- Cause of Action #27: Fraud (MK and Meyers);
- Cause of Action #30: Breach of Contract (MK);
- Cause of Action #31: Breach of Fiduciary Duty (MK and Meyers);
- Cause of Action #33 Aiding and Abetting Breach of Fiduciary Duty (MK and Meyers); and
- Cause of Action #35 Unjust Enrichment (MK and Meyers).

[2] As further evidentiary support for his Opposition to the Motion ("Trustee's Objection"), the Trustee submitted the affidavits of Robert J. Caughman, William Danielson, John Paul Holmes, III, Scott Matula, and Luther Clark Marshall (collectively "Summary Judgment Affidavits"). The MK Defendants moved to strike the Summary Judgment Affidavits. As set forth in the Court's Order finding the MK Defendants' motion to strike moot, the Court reviewed the Summary Judgment Affidavits, but did not base any portion of this opinion on the information or statements contained in therein.

Court's entry of final orders and judgments. 28 U.S.C. § 157(c); *see Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1940 (2015); *see generally In re Standing Order Concerning Title 11 Proceedings Referred Under Local Rule 83.IX.01, Referral to Bankruptcy Judges*, Misc. No. 3:13-mc-00471-TLW (D.S.C. Dec. 5, 2013).

FINDINGS OF FACT[3]

1. IBG was incorporated in 2003 under the laws of the State of Nevada. IBG operated its business primarily out of offices in South Carolina and Kentucky, with a small office in Florida.

2. IBG was in the business of collecting dishonored checks on behalf of entities that received the checks as payment from third-party vendors. IBG entered into contracts with merchants to collect bounced or "NSF" checks, and offered two programs to its customers: a Guaranteed Program[4] and a Non-Guaranteed Program.[5]

3. IBG had two facilities, more than sixty (60) employees, and many customers, including several large national financial institutions.

4. IBG's corporate bylaws ("Bylaws") provide that the business and affairs of IBG were to be managed by IBG's Board of Directors ("Board"). The Bylaws gave the Board "the right . . . to delegate any specific powers . . .to any other officer or officers of the corporation." It appears from the record that IBG's management was responsible for the day-to-day operations of the

[3] To the extent any of the Findings of Fact constitute conclusions of law, they are adopted as such, and to the extent any of the Conclusions of Law constitute findings of fact, they are so adopted.

[4] Under the fee-based Guaranteed Program, IBG purchased a NSF check from the merchant for the face amount of the check. IBG was then responsible for collecting the face amount of the check and the state mandated collection fee both of which, if collected, were retained by IBG.

[5] Under the Non-Guaranteed program, the customer engaged IBG to attempt to collect a NSF check on the customer's behalf. If IBG was successful in its collection efforts, it paid the face amount of the check to the customer and retained for itself the state mandated fee.

company, including servicing customers, business development, overseeing daily sales numbers, assisting with capital raises, preparing the financials, and making presentations to the Board.

5. The Management Defendants are comprised of the following individuals:

a. Wade B. Cordell ("W. Cordell") was IBG's President and Chairman of the Board from 2004 until approximately August 2009. W. Cordell's duties as Board Chair are set out in the Bylaws,[6] and his duties as President are described in his employment contract with IBG dated March 20, 2007. The record reflects that W. Cordell executed various contracts on behalf of the Debtor in his capacity as President and Board Chair, including the April 2008 Management Representation Letter.[7] In addition, W. Cordell oversaw IBG's sales and met with prospective customers.

b. O. Brad Cordell ("B. Cordell")[8] was IBG's Chief Operating Officer ("COO") and a Board member from 2004 until approximately August 2009. As COO, B. Cordell was responsible for managing the daily operations of IBG and for achieving the Debtor's financial targets. B. Cordell's other duties are described in his employment contract with the Debtor dated March 20, 2007.

c. John Blevins ("Blevins") was IBG's in-house General Counsel/Chief Legal Officer, and a Board member from 2003 until approximately August 2009. Blevins was in charge of compliance, and had all authority and responsibility for legal issues affecting the Debtor, including contract review and negotiation, and providing advice and counsel to the Board, President, and CEO. Blevins had other duties that are described in his employment contract with the Debtor dated March 30, 2007.

d. Byron Sturgill ("Sturgill") was IBG's Chief Executive Officer ("CEO") and a Board member from 2003 until July 2010. Sturgill oversaw the preparation of the Debtor's financial statements, and was responsible for the hiring of the Debtor's outside accounting firm Grafton and Company, P.L.L.C. ("Grafton"). The Bylaws granted Sturgill, as CEO, "general and active management of the business of [IBG], subject . . . to

[6] The Bylaws provide that the Chair is responsible for presiding at meetings of the Board and shareholders. The Bylaws also state that the Chair is responsible for ensuring that wishes of the Board are carried out, unless the Board has delegated that duty to another corporate officer.

[7] *See, infra* at ¶ 16.

[8] W. Cordell and B. Cordell will be collectively referred to herein as "the Cordells."

the right of the [Board] to delegate any specific powers . . . to any other officer or officers of [IBG]." Sturgill's other duties are described in his employment contract with the Debtor dated March 20, 2007. It appears from the record that Sturgill executed various contracts on behalf of the Debtor, including Haines Hargrett's employment contract, and the March and April 2008 Management Representation Letters.

e. Haines Hargrett ("Hargrett") was IBG's Chief Financial Officer ("CFO") from September 2006 until July 2010. Hargrett did not sit on the Board, but he reported to the Board and frequently attended Board meetings. Hargrett was responsible for presenting financial information to the Board and he, together with Sturgill, was responsible for preparation of IBG's internal financial statements and dealing with Grafton. Hargrett's other duties are set forth in his employment contract with the Debtor dated September 2006. Hargrett is the third signatory on the April 2008 Management Representation Letter, signing in his capacity as CFO.

6. William Van Hoven ("Van Hoven") served on the Board from 2004 until 2010. In addition, Van Hoven was employed by the Debtor in various capacities, ultimately serving as the Director of Information and Technology. Aside from the Management Defendants who served on the Board, Van Hoven is the only member of the Board that was also an employee of the Debtor.

7. Michael Potter ("Potter") served on the Board from 2003 until 2007, and again from 2009 until 2010. After 2004, Potter rarely attended Board meetings. Potter had no involvement in the day-to-day operations of the Debtor and he relied heavily, if not exclusively, on Sturgill for advice and information related to IBG.

8. Tom Handy ("Handy") joined the Board on June 24, 2008 and resigned in March 2010. Handy was a regular attendee of Board meetings, but had no involvement with the day-to-day operations of the Debtor.

9. At some point in 2003 or 2004, the accounting policy at issue in this case was created and implemented ("Accounting Practice"). In simplest terms, the accounts receivable reflected in the

Debtor's financial statements failed to account for the possibility that not all items given to IBG for collection would be collected. This resulted in material overstatements of the Debtor's revenue, net income, and accounts receivable. The material misstatements regarding IBG's true financial condition were not only in IBG's internal financial statements and the financial statements prepared by Grafton, but also carried over to financial information provided by IBG to outside third parties (*i.e.* customers and investors, as well as prospective customers and investors).

10. Although it is not clear who was first responsible for implementation of the Accounting Practice, it is undisputed that Sturgill and Hargrett were responsible for preparation of IBG's internal financial statements.

11. Each of the Management Defendants had actual knowledge of the Accounting Practice, and knowledge that financial information conveyed by the Accounting Practice (which the Trustee asserts was erroneous) was being provided to outside third parties.

12. Grafton was engaged by IBG to conduct audits of IBG in accordance with generally accepted accounting principles ("GAAP"), and to provide IBG with annual audit opinions.

13. The internal financial statements prepared by Sturgill and Hargrett were given to Grafton, who used them to prepare the "Grafton Audited Financials" for the years 2003 through at least 2008 (collectively "Grafton Financials").

14. The cover letter to the Grafton Financials is addressed to the Board. In the cover letter, Grafton represents that it conducted an audit of IBG in accordance with GAAP. The cover letter also states that the IBG internal financial statements "are the responsibility of [IBG's] management."

15. The Notes to the Grafton Financials, which "are an integral part to the statements," state:

> Accounts Receivable Recognition
>
> The Company offers two programs for collection assistance of NSF Checks, a Guaranteed Program, which is fee based and a Non Guaranteed Program, which is not fee based and is offered at no cost to the customer. The Company uses a proven proprietary risk assessment in order to decide which program to offer a particular merchant. The Accounts Receivable that arises from each program is recognized as follows. The guaranteed program assures the customer that it will be reimbursed for any check that is returned NSF. This requires that the Company buy the check for the face amount of the check when returned NSF. The Company is then responsible for collecting the face amount of the check plus the state mandated fee. Once the Company has purchased these checks, the face amount of the check plus the state mandated bad check fee are recorded as accounts receivable since the Company is now entitled to and [sic] actively collecting that amount. The Non Guaranteed program, since it is not guaranteed, only entitles the Company to the state mandated fee since the customer will be paid for the face once the check is collected. For the Non Guaranteed Program, the Company only records an Accounts Receivable for the amount of the State Mandated fee. Under the Non Guaranteed Program, unlike the Guaranteed Program where the Company owns the check, the customer still has rights to the check and can request the check back after so many days. However, the Company by contract is still entitled to [sic] state mandated fee.
>
> Allowance for doubtful accounts
>
> Accounts receivable balances are stated net of allowance for doubtful accounts. This allowance is based on the Company's historical experience. Historically, the Company has not encountered significant write-offs.

Grafton Financials, Notes to Financial Statement, December 31, 2006.[9]

16. In April 2008 Hargrett as IBG's CFO, W. Cordell as its President and Chair, and Sturgill as its CEO, executed and delivered to Grafton a representation letter ("Management Representation Letter") that stated, "we are responsible for the fair presentation in the financial statements of financial position, results of operation, and cash flows in conformity with GAAP."

17. All members of the Board had the opportunity to review the Grafton Financials.

[9] The same language appears in each of the relevant Grafton Financials.

18. IBG engaged Morgan Keegan on two separate occasions. The first engagement (the "2006 Engagement") began on or about March 16, 2006.

19. Although the Complaint and the Trustee's Objection frequently reference a 2006 Referral Agreement allegedly entered into by IBG and MK, there is no evidence that this document was ever executed by MK and the Debtor, and a signed copy of the document is not in the record.

20. After their retention in March 2006, Sturgill provided the MK Defendants with electronic copies of various financial reports.

21. It is clear from the record that the MK Defendants had actual knowledge of the Accounting Practice.

22. The MK Defendants worked with the Management Defendants in preparing various documents, including a Private Placement Memorandum dated in or around November 2006 ("2006 PPM"), and a 2006 Confidential Investor's Memorandum ("2006 CIM").

23. Pursuant to the terms of the Debtor's first contract with the MK Defendants ("2006 Contract"), the MK Defendants were only paid if they were able to raise institutional capital for IBG. The MK Defendants failed to raise institutional capital for IBG during the term of the 2006 Contract; therefore, pursuant to the terms of the 2006 Engagement, the MK Defendants received no compensation from IBG.

24. IBG ended the 2006 Engagement sometime in 2007.

25. On January 8, 2007, a board meeting was held ("January 2007 Board Meeting"). All of the Management Defendants were present, as was Van Hoven. Potter was not present; however, because five of the six Board members were present, there was a quorum, enabling the Board to conduct business.

26. The minutes from the January 2007 Board Meeting ("January 2007 Minutes") state:

> Haines Hargrett then addressed the board concerning the 2006 financial statements and discussed [sic] ensued regarding changing the way the revenues of the company are booked, i.e. checks in the system waiting for collection. It was decided unanimously that it is in the Company's best interests to maintain the status quo and not to change the reporting method. It was also decided unanimously to continue with Grafton & Company as the Company auditors for 2006.

27. The January 2007 Minutes are signed by Robert Caughman ("Caughman"), who became IBG's corporate secretary in October 2006. Caughman did not attend the January 2007 Meeting, but drafted the January 2007 Minutes based on notes taken by Blevins, who attended the January 2007 Meeting.

28. At the Annual Shareholder Meeting held in November 2007, Potter was not re-elected to the Board. From November 2007 until June 2008 when Handy joined the Board, the Board was comprised of only five (5) members: the Cordells, Blevins, Sturgill, and Van Hoven.

29. The MK Defendant's second engagement began on or about April 24, 2008 ("2008 Engagement"). Pursuant to the terms of the Debtor's second contract with the MK Defendants ("2008 Contract"), the MK Defendants were only paid if they were able to close a financing transaction for IBG. It is unclear when the 2008 Engagement ended.

30. The MK Defendants failed to close any financing deals for IBG, and received no compensation from IBG under the 2008 Contract.

31. In late June or early July 2008, Transactions Services, LLC issued a Financial Due Diligence Report on IBG ("Transactions Services Report") for Morgan Keegan Strategic Fund, L.P., from whom IBG was attempting to obtain a loan. The Transaction Services Report stated that IBG's earnings before interest, taxes, depreciation, and amortization (EBITDA) for the twelve-month period ending April 30, 2008, were overstated by over $5 million dollars, and that

its EBITDA forecast of over $10.1 million for December 31, 2008, was overstated by more than $10.3 million dollars.

32. The Management Defendants and MK Defendants had actual knowledge of the Transaction Services Report. It does not appear from the record that either the contents of the Transaction Services Report, or a copy of the report, were provided either to Board members Van Hoven and Handy, or to any the shareholders who were not Management Defendants.

33. At a Special Board Meeting held in August 2008, the Board authorized the President (W. Cordell), on behalf of the Debtor, to issue certain debt instruments to individual accredited investors, based on terms to be determined by the President.

34. For the period of at least 2006 to 2009, IBG attempted to raise capital through the sale of territories, stock sales, and investor notes. IBG was successful in its efforts to raise money and, although the exact amount raised is unclear, it appears that IBG raised approximately $21,000,000, if not more, from various sources over at least a three-year period. Funds were raised through sales of shares to investors (in part via the 2006 PPM), and through the issuance of the so called 2008 Mezzanine Debt Instruments and 2008 Promissory Notes.

35. It is clear from the record that certain of the Management Defendants used corporate funds to pay for questionable personal and/or business expenses. It is not clear from the record exactly how much of IBG's money the Management Defendants diverted for these expenses.

36. It appears from the record that certain of the Management Defendants received bonuses and high salaries that were not approved by the Board.

37. In addition to the questionable expenditures of corporate funds, it appears that certain of the Management Defendants caused corporate stock to be issued to various third parties for little or no consideration.

38. The dollar amount attributable to the questionable spending and stock issuances is not clear from the record; however, it appears that these practices may have cost the Debtor between 2 and 3.5 million dollars.

39. The Management Defendants the Cordells, Blevins, and Sturgill, comprised a majority of the Board until August 2009.

40. In August 2009, certain shareholders, led by Sturgill and Hargrett, attempted to terminate the Cordells and Blevins' employment with the Debtor and to oust them from the Board.

41. In response to the attempted termination, the Cordells and Blevins filed a lawsuit on their behalf and on behalf of the Debtor in the South Carolina State Court ("State Court Litigation").

42. The State Court Litigation was ultimately settled, with the Cordells and Blevins resigning from both their employment with IBG and the Board. The other terms and conditions of the settlement are set forth in the settlement agreement executed by the parties to the State Court Litigation, which is part of the record herein.

43. In September 2009, after the withdrawal of the Cordells and Blevins, the Board reorganized, increasing its membership from six (6) to nine (9), and reducing the number of inside directors from four to one (Sturgill).

44. In July 2010, the Board fired Sturgill. At this same time, Hargrett was placed on leave, and his employment was eventually terminated.

45. The Debtor filed for bankruptcy on September 1, 2010. The Trustee commenced this adversary proceeding on August 31, 2012 against the MK Defendants, the Management Defendants, and Grafton.

CONCLUSIONS OF LAW

I. Summary Judgment Standard

Federal Rule of Civil Procedure 56, made applicable in this adversary proceeding by Bankruptcy Rule 7056, provides that, "[t]he court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." "One of the principal purposes of the summary judgment rule is to isolate and dispose of factually unsupported claims or defenses, and . . . [the rule] should be interpreted in a way that allows it to accomplish this purpose." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323–24 (1986).

As explained by the Supreme Court:

> the plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial. In such a situation, there can be "no genuine issue[10] as to any material fact," since a complete failure of proof concerning an essential element of the nonmoving party's case necessarily renders all other facts immaterial. The moving party is "entitled to a judgment as a matter of law" because the nonmoving party has failed to make a sufficient showing on an essential element of her case with respect to which she has the burden of proof.

Id. at 322–23 (*citing Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986)).

Once the movant has met its burden, the burden of proof shifts to the opposing party to come forward with "any of the kinds of evidentiary materials listed in Rule 56(c)," and to designate "specific facts showing that there is a genuine issue for trial." *Id.* at 324; *Mantushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986). The non-movant "must do more than simply show that there is some metaphysical doubt as to the material facts."

[10] In the years since *Celotex*, Rule 56 has been amended to replace the term "issue" with the term "dispute," to "better reflect the focus of a summary-judgment determination." Fed. R. Civ. P. 56 advisory committee's note to 2010 amendment.

Mantushita, 475 U.S. at 586. Instead, the non-movant must identify specific evidence in the record and articulate the precise manner in which that evidence supports his claim. *Adams v. Travelers Indem. Co. of Conn.*, 465 F.3d 156, 164 (5th Cir. 2006). Rule 56 does not impose a duty on the Court to "sift through the record in search of evidence to support a party's opposition to summary judgment." *Id.*; *see also Holland v. Sam's Club*, 487 F.3d 641, 644 (8th Cir. 2007 (the court "is not obligated to wade through and search the entire record for some specific facts which might support the nonmoving party's claim . . . ."); *Al-Haqq v. Worrick*, 2014 U.S. Dist. Lexis 181487 at *4 (D.S.C. October 30, 2014) (same).

"Only disputes over facts that might affect the outcome of the suit under governing law will property preclude the entry of summary judgment." *Anderson*, 477 U.S. at 248. "[T]here is no issue for trial unless there is sufficient evidence favoring the nonmoving party for a jury to return a verdict for that party . . . . If the evidence is merely colorable or is not significantly probative, summary judgment may be granted." *Id.* at 249-50 (internal citations omitted).

A party cannot prevail on a motion for summary judgment by creating a genuine issue of material fact through mere speculation "or the building of one inference upon another." *Beale v. Hardy*, 769 F.2d 213, 214 (4th Cir. 1985). Summary judgment is inappropriate if the parties disagree on the inferences that may reasonably be drawn from the undisputed facts, and is proper if only one conclusion may reasonably be drawn. *Pulliam Inv. Co., Inc. v. Cameo Properties*, 810 F.2d 1282 (4th Cir. 1987); *Croft v. Bayview Loan Servicing*, LLC, 166 F. Supp. 3d 638 (D.S.C. 2016) (same).

Finally, when reviewing the facts and evidence produced by the parties, the Court must draw all reasonable inferences in favor of the nonmoving party, and:

> [c]redibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge,

> whether he is ruling on a motion for summary judgment or for a directed verdict. The evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor.

Anderson, 477 U.S. at 255. Furthermore, "[a]t the summary judgment stage, the judge's function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." *Id.* at 242–43.

II. Statute of Limitations

A. MK Defendants are entitled to summary judgment as a matter of law on that portion of the Trustee's Thirtieth Cause of Action Related to Breach of the 2006 Contract.

The Court finds that the MK Defendants are entitled to summary judgment as a matter of law on the Trustee's claims related to the alleged breach of the 2006 Contract because these claims are barred by the applicable statute of limitations.

Under Delaware law, which governs the 2006 Contract,[11] the statute of limitations for an action for breach of contract is three (3) years. Del. Code Ann. tit. 10, § 8106 (West 2015). In Delaware, "[the] right of action accrues and the Statute begins to run at the time the contract is broken, not at the time when actual damage results or is ascertained." *Worrel v. Farmers Bank Del.*, 430 A.2d 469, 472 (Del. 1980) (internal citation omitted); *Commonwealth Land Title Ins. Co. v. Funk*, 2014 WL 8623183, at *7 (Del. 2014) (same).

The 2006 Contract is dated March 16, 2006. Although the record is not clear on the exact date the contract was terminated, it is undisputed that the termination occurred sometime between March 16, 2006 and March 6, 2007.[12] Therefore, any breach of the 2006 Contract had to have occurred, at the latest, on or before the March 6, 2007 expiration date.

[11] The parties agree that Delaware law governs the 2006 Contract.

[12] The document itself provides that the 2006 Contract expired on March 6, 2007 if not renewed.

Applying Delaware's three year statute of limitations, the limitations period ran on the Trustee's breach of contract claim, at the latest, in March 2010, approximately six (6) months before the filing of the petition and almost two and a half years before the filing of the adversary. The Trustee's claims under the 2006 Contract are barred by the statute of limitations and therefore, the MK Defendants are entitled to summary judgment as a matter of law on this cause of action.

B. A question of fact exists as to when the Statute of Limitations began to run on the Trustee's Securities Fraud Claims.

Title 28 U.S.C. § 1658(b) sets forth the statute of limitations for the Trustee's federal securities fraud claims. Section 1658 provides that the Trustee was required to bring these claims against the MK Defendants, "not later than the earlier of--(1) 2 years after the discovery[13] of the facts constituting the violation; or (2) 5 years after such violation." 28 U.S.C. § 1658(b). As explained by the Supreme Court:

> the limitations period in § 1658(b)(1) begins to run once the plaintiff did discover or a reasonably diligent plaintiff would have "discover[ed] the facts constituting the violation"—whichever comes first. In determining the time at which "discovery" of those "facts" occurred, terms such as "inquiry notice" and "storm warnings" may be useful to the extent that they identify a time when the facts would have prompted a reasonably diligent plaintiff to begin investigating. But the limitations period does not begin to run until the plaintiff thereafter discovers or a reasonably diligent plaintiff would have discovered "the facts constituting the violation," including scienter—irrespective of whether the actual plaintiff undertook a reasonably diligent investigation.

Merck & Co. v. Reynolds, 559 U.S. 633, 653 (2010).

When raising the statute of limitations as a defense to a securities fraud claim, the burden is on the defendant asserting the defense to demonstrate that a reasonably diligent plaintiff would

[13] "[I]n the statute of limitations context, the word 'discovery' is often used as a term of art in connection with the 'discovery rule,' a doctrine that delays accrual of a cause of action until the plaintiff has 'discovered' it." *Merck & Co. v. Reynolds*, 559 U.S. 633, 644 (2010).

have discovered "the facts constituting a violation." *Merck*, 559 U.S. at 654. If there is conflicting evidence in the record on the issue of whether the plaintiff knew or should have known of the existence of a cause of action, the question is one for the jury. *Manios v. Nelson, Mullins, Riley & Scarborough, LLP*, 697 S.E.2d 644, 654 (S.C. Ct. App. 2010) (if the evidence is conflicting on the issue of whether a party knew or should have known of the existence of a cause of action, the issue must be resolved by the fact finder); *see Johnson v. Bowen*, 473 S.E.2d 45, 65 (S.C. 1993) ("Whether a claimant knew or should have known that they had a cause of action is a question for the jury.").

The MK Defendants argue that upon their receipt of the Grafton Financials from IBG in March 2006, knowledge of the facts constituting the securities violation was contemporaneously imputed to the Debtor, and the statute of limitations began to run at this time. Assuming, for the sake of argument, that the MK Defendants are correct that the delivery of the Grafton Financials by Sturgill in March 2006 was the triggering event, the Court must still deny the Motion because questions of fact exist on the issue of whether Sturgill's knowledge and that of the Management Defendants was imputed to IBG. As discussed later in this opinion, as a corporation, IBG derived its knowledge from its agents. *See infra* at IV.B. Generally speaking, knowledge of corporate agents is imputed to the principal as a matter of law. However when, as in this case, there are questions of fact regarding the authority of the corporate agents, imputation of the agent's knowledge to the principal cannot be presumed. Therefore, summary judgment cannot be granted on this issue.[14]

[14] Although not argued by the Trustee, the Court also notes that to prevail on a claim for securities fraud, the record must show that the defendant made a material misstatement with the intent to deceive. *Merck*, 559 U.S. at 648-649. The Grafton Financials were not "statements" made by the MK Defendants; therefore, they could not form the basis of the Trustee's securities fraud claims.

III. MK Defendants are entitled to Summary Judgment on the Thirty-Fifth Cause of Action, Unjust Enrichment.

The Trustee's Thirty-Fifth cause of action asserts a claim against the MK Defendants for unjust enrichment arising out of the 2006 and 2008 Contracts. To prevail on a claim for unjust enrichment,[15] the Trustee has the burden of pleading and proving that: (a) the Debtor conferred a benefit on the MK Defendants; (b) the MK Defendants realized the benefit; and (c) the MK Defendants' retention of the benefit under the circumstances would be inequitable. *Myrtle Beach Hosp., Inc. v. City of Myrtle Beach,* 532 S.E.2d 868, 872 (S.C. 2000); *Columbia Wholesale Co., Inc. v. Scudder May, N.V.,* 440 S.E.2d 129, 130 (S.C. 1994).

Under the unambiguous terms of both the 2006 and 2008 Engagements, the MK Defendants were not entitled to receive any compensation unless they closed a transaction that raised institutional capital for the Debtor.[16] It is undisputed that no transaction was closed under either contract. The undisputed testimony of Myers is that the MK Defendants received no compensation from the Debtor. Myers' testimony is supported by the testimony of other witnesses (*see, e.g.,* Depositions of Blevins and Handy), none of whom testified that IBG had compensated the MK Defendants.

On this issue, and in opposition to the Motion, the Trustee merely states that, "evidence establishing consideration flowing from the Debtor to MK will be presented at trial." Trustee's Objection at 47. Beyond this self-serving statement, the Trustee has failed to direct the Court's attention to any evidence in the record showing that IBG conferred a benefit that was realized

[15] It appears that South Carolina law applies to the unjust enrichment cause of action. Nevertheless Georgia law and Delaware law, the jurisdictions selected in the choice of law provisions contained in the 2006 Contract and 2008 Contract, apply similar standards for establishing an unjust enrichment claim.

[16] The 2006 Contract and 2008 Contract each provide: "As compensation for Morgan Keegan's services hereunder, [IBG] agrees to pay Morgan Keegan a contingent equity placement fee . . . in cash at closing equal to [an agreed upon percentage] of the gross proceeds raised on behalf of [IBG]."

and retained by the MK Defendants. After a review of the voluminous documentation submitted by the Trustee in opposition to the Motion, the Court has found none.

At this stage of the proceedings, and in response to a motion for summary judgment on an issue on which he has the ultimate burden of proof, the Trustee must point to specific evidence in the record showing the existence of a genuine issue of material fact related to his unjust enrichment claim. The Trustee has failed in this regard. Therefore, the MK Defendants are entitled to summary judgment in their favor on the Thirty-Fifth Cause of Action.

IV. Genuine disputes of material facts preclude the Court from granting the MK Defendants summary judgment on the remainder of the Trustee's claims.

With respect to the remaining claims,[17] the MK Defendants assert that they are entitled to summary judgment based on the affirmative defense of *in pari delicto*.

A. Governing Law

As discussed in the Court's June 19, 2013 Order Denying the MK Defendant's Motion to Dismiss ("June 2013 Order"), South Carolina, as the forum state for this litigation, provides the rules governing the choice of law determination in this matter. *Anderson v. Cordell* (*In re Infinity Bus. Grp.*), 497 B.R. 794, 804 (Bankr. D.S.C. 2013). Because the Trustee's claims sounding in tort allege injuries to a corporate entity who's "nerve center" was located in South Carolina, South Carolina law governs the application of the *in pari delicto* defense to the tort claims. *Id.* at 804. South Carolina law also governs the Trustee's federal securities claims.

The Debtor is a Nevada corporation. Therefore, Nevada law governs the application of the *in pari delicto* defense to the Trustee's breach of fiduciary duty and aiding and abetting breach of fiduciary duty claims. *Id.*; *Menezes v. WL Ross & Co., LLC*, 709 S.E.2d 114, 117 (S.C.

[17] The primary argument set forth in the Motion is that the Trustee's remaining claims (including those ruled on by the Court in sections II and III of this Order), are barred by *in pari delicto*.

Ct. App. 2011) (holding that claims concerning fiduciary duties of corporate officers are governed by the state of incorporation) (citing *Restatement (First) of Conflicts of Laws,* § 187 (1934)). Georgia law governs the application of the doctrine to the Trustee's cause of action for breach of the 2008 MK Contract because of the contract's choice of law provision.

With respect to the governing law on the imputation issues, there is no federal common law "on such a generalized issue." *O'Melveny & Myers v. FDIC*, 512 U.S. 79, 84 (1994); *see generally Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938) ("There is no federal general common law."). Therefore, when ruling on the issue of imputation of the Management Defendants' knowledge to the Debtor, state law controls. *O'Melveny, supra* at 84.

B. *In pari delicto*

The equitable doctrine of *in pari delicto*[18] precludes a party who has participated in a wrongdoing with another, and who bears equal or greater fault for the wrongdoing, from recovering damages arising from the wrongdoing from his joint-tortfeasor. *Grayson Consulting, Inc. v. Wachovia Sec., LLC* (*In re Derivium Capital, LLC*), 716 F.3d 355 (4th Cir. 2013); *In re AMERCO Derivative Litig.*, 252 P.3d 681 (Nev. 2011); *see generally Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306-307 (1985) (discussing the *in pari delicto* defense, its origins, and application); Ga. Code Ann. § 23-1-15 (West 2016) ("When both parties are equally at fault, equity will not interfere but will leave them where it finds them."). *In pari*

[18] As explained by one court:

> Latin for "in equal fault," *in pari delicto* is a general rule that courts "will not extend aid to either of the parties to a criminal act or listen to their complaints against each other but will leave them where their own act has placed them." The underlying idea is that there is no societal interest in providing an accounting between wrongdoers.

American Int'l Grp., Inc. v. Greenberg, 976 A.2d 872, 882 (Del. Ch. 2009), *aff'd sub nom. Teachers' Ret. Sys. of Louisiana v. General RE Corp.*, 11 A.3d 228 (Del. 2010) (internal citations omitted).

delicto is consistently applied by this and other courts to bar suits by bankruptcy trustees against alleged tortfeasors when the debtor bears equal or greater culpability for the alleged tortious conduct as the alleged tortfeasor. *See, e.g.*, *Derivium*, 716 F.3d at 367; *USACM Liquidating Tr. v. Deloitte and Touche*, 754 F.3d 645, 647 (9th Cir. 2014) (affirming the lower court's grant of summary judgment based on defendants' assertion of *in pari delicto* in an action brought by the liquidating trustee against the debtor's former accountants; applying Nevada law); *Official Comm. of Unsecured Creditors of PSA, Inc. v. Edwards*, 437 F.3d 1145 (11th Cir. 2006) (*in pari delicto* applies with equal force to bankruptcy trustees; applying Georgia law).

In this case, the MK Defendants argue that the Management Defendants' implementation of the Accounting Practice should be imputed to the Debtor, such that the Trustee, standing in the shoes of IBG, is barred from recovering against the MK Defendants for the Debtor's own wrongdoing. Because *in pari delicto* is an affirmative defense upon which the MK Defendants will bear the ultimate burden of proof at trial, the MK Defendants must show to the Court's satisfaction that there is no issue as to any fact material to the defense. *Celotex*, 477 U.S. at 322-23.

1. Imputation

A corporation gains knowledge and acts through its agents.[19] Consequently, when considering the *in pari delicto* defense, the Court must first determine whether the knowledge

[19] A basic tenant of agency law is that:

> [a] corporation can acquire knowledge or receive notice only through its officers and agents, and hence the rule holding a principal, in case of a natural person, bound by notice to his agent is particularly applicable to corporations, the general rule being that the corporation is affected with constructive knowledge, regardless of its actual knowledge, of all the material facts of which its officer or agent receives notice or acquires knowledge while acting in the course of his employment and within the scope of his authority, and the corporation is charged with such knowledge even though the officer or agent does not in fact communicate his knowledge to the corporation.

and actions of the Debtor's agents — the Management Defendants — are imputed to the Debtor. If the Court finds that the knowledge and actions of the Management Defendants are imputed to the Debtor, then the Court must next determine whether any of the exceptions to the *in pari delicto* defense are present.

In the case at bar, it is undisputed that each of the Management Defendants had actual knowledge of the Accounting Practice.[20] The parties vigorously dispute, however, whether this knowledge should be imputed to the Debtor.

a. Whether IBG had knowledge of the Accounting Practice derived from the actual knowledge of the Board.

The MK Defendants assert that the entire Board, as the governing body for IBG, had actual knowledge of the Accounting Practice and that this actual knowledge is imputed to IBG. In support of this argument, the MK Defendants first point to the Grafton Financials which they assert, "explicitly describe" the Accounting Practice. The MK Defendants also direct the Court to evidence in the record that the Board had the opportunity to review the Grafton Financials and ask questions about their contents.

The MK Defendants also argue that evidence of the Board's actual knowledge and approval of the Accounting Practice can be found in the January 2007 Minutes, which state that the Board discussed the Accounting Practice during the January 2007 Board Meeting and then voted to continue the practice. According to the MK Defendants, this factor, either standing alone or coupled with the other factors described herein, is evidence of the entire Board's actual

In re AMERCO Derivative Litig., 252 P.3d 681, 695 (2011) (*citing Stohecker v. Mutual B. & L. Ass'n.*, 34 P.2d 1074, 1077 (Nev. 1934)); *see Anderson v. Cordell* (*In re Infinity Bus. Grp.*), 479 B.R. 794, 803 (Bankr. D.S.C. 2013); *Georgia Power Co. v. Busbin*, 250 S.E.2d 442, 444 (Ga. 1978) (corporations act through their agents).

[20] In the Motion, the parties' focus appears to be on the collective actions and knowledge of the Management Defendants.

knowledge and approval of the Accounting Practice, which knowledge should be imputed to the Debtor.

In response to the MK Defendants' assertions, the Trustee points to evidence in the record that he believes gives rise to genuine disputes of material fact on this issue. First, the Trustee challenges the quality and clarity of the disclosures contained in the Grafton Financials, citing to the testimony of several witnesses, including Handy and Van Hoven, each of whom testified that even after reviewing the Grafton Financials, they did not know about the Accounting Practice (*i.e.* that the accounts receivable reflected in the Grafton Financials failed to account for the possibility that not all checks given to IBG would be collected). The Trustee also argues that the notes to the Grafton Financials contradict the documents' alleged "disclosure" of the Accounting Practice, and that this internal contradiction neutralizes the effectiveness of the disclosures.[21]

Addressing the issue of the January 2007 Minutes, the Trustee argues that a question of fact exists as to whether the Accounting Practice was, in fact, discussed at the January 2007 Board Meeting. The Trustee directs the Court to the deposition testimony of Van Hoven, which he says contradicts both the January 2007 Minutes and other witness' testimony regarding the events occurring at that Board meeting.[22]

[21] *Compare, e.g.*, Grafton Financials, Notes to Financial Statement, December 31, 2005 at "Accounts Receivable Recognition," ("[After IBG] has purchased these checks, the face amount of the check plus the state mandated bad check fee are recorded as accounts receivable . . . .") *with* Grafton Financials, Notes to Financial Statement, December 31, 2005 at "Allowance for doubtful accounts" ("Accounts receivable balances are stated net of allowance for doubtful accounts.").

[22] For example, Management Defendant Blevins, who was present at the January 2007 Meeting and took the notes from which the January 2007 Minutes were drafted, testified that the Accounting Practice was discussed at the January 2007 Meeting. In contrast, Van Hoven, who was also present at the January 2007 Meeting, denies that the Accounting Practice was discussed.

Viewing the facts in a light most favorable to the Trustee, the Court finds that, although certain members of the Board had actual knowledge of the Accounting Practice, there are genuine disputes as to the actual knowledge of each individual member of the Board, precluding a summary finding that the Board, as a governing body, possessed actual knowledge of the Accounting Practice. For example, although the MK Defendants contend that that all members of the Board knew about the Accounting Practice from the Grafton Financials, this conclusion is called into question by the testimony of Van Hoven and Handy. It appears that even though he was familiar with the Grafton Financials, even as late as his October 2015 deposition, Van Hoven did not believe that there were any problems with the financials. Handy, who knew in the summer and fall of 2009 that there were problems with IBG's management, did not believe it was necessary for the Board to write off the overstated accounts receivable after the Cordells and Blevins were ousted.

Even if the Court agreed with the MK Defendants that the Grafton Financials gave the Board actual notice of the Accounting Practice, it is arguable that the notice is contradicted by other language appearing in the financials, rendering the disclosure of the Accounting Practice ambiguous.[23] On a motion for summary judgment, the Court must construe all ambiguities in a light most favorable to the non-moving party, and resolve all justifiable inferences in the non-movant's favor. *Anderson v. Liberty Lobby*, 477 U.S. at 255; *Morrison v. Nissan Motor Co.*, 601 F.2d 139, 141 (4th Cir. 1979).

With respect to the discussions regarding the Accounting Practice reflected in the January 2007 Minutes, issues of witness credibility prevent a ruling in the MK Defendants' favor. On the one hand, the January 2007 Minutes state that a discussion was held:

[23] *See*, *supra* n.21.

> concerning the 2006 financial statements [to discuss] changing the way the revenues of [IBG] are booked, *i.e.* checks in the system waiting for collection. It was decided unanimously that it is in [IBG]'s best interests to maintain the status quo and not to change the reporting method.

January 2007 Minutes. Blevins, the Debtor's former General Counsel and one of the Management Defendants, was present at the January 2007 Meeting and took the minutes in question. Blevins testified in his deposition that the Accounting Practice was discussed at length at the January 2007 Meeting, and at other times outside of formal Board meetings. However Van Hoven, who also attended the January 2007 Meeting, testified in his deposition that the Accounting Practice was not discussed. When deciding a motion for summary judgment, it is not the role of this Court to rule on the issue of witness credibility. *Anderson v. Liberty Lobby*, 477 U.S. at 255. Rather, this factual issue, together with the others discussed herein, must be left to for the fact finder to decide at trial, precluding summary judgment.

b. Whether constructive knowledge of the Accounting Practice is imputed to IBG.

Even if IBG lacked actual knowledge of the Accounting Practice, constructive knowledge of the practice may be imputed to IBG if the facts show that the Accounting Practice was implemented by the Management Defendants acting within the scope of their authority as officers and agents of IBG.

A corporation is bound by the acts of its agent when the agent acts within the scope of the agent's authority. *AMERCO*, 252 P.3d at 694–95 ("Under basic corporate agency law, the actions of corporate agents are imputed to the corporation . . . . [and] the corporation is affected with constructive knowledge . . . of all the material facts of which its officer or agent receives notice or acquires knowledge while acting in the course of his employment and within the scope of his authority . . . ."); *Chicagoland Vending, Inc. v. Parkside Center, Ltd.*, 454 S.E.2d 456, 457

(Ga. 1995) ("the law imputes to the principal all notice or knowledge concerning the subject matter of the agency which the agent acquires while acting as agent and within the scope of his authority. . . ."); *Crystal Ice Co. v. First Colonial Corp.*, 257 S.E.2d 496, 497 (S.C. 1979) (a principal is affected with constructive knowledge of all material facts of which his agent receives notice while acting within the scope of his authority); *Bankers Trust of S.C. v. Bruce*, 323 S.E.2d 523, 532 (S.C. Ct. App. 1984) (same).

Officers of a corporation have the authority set forth in the corporation's bylaws, or determined by the corporation's board. Nev. Rev. Stat. § 78.130(3) (West 2015) ("[O]fficers . . . have such powers and duties as may be prescribed by the bylaws or determined by the board of directors."); S.C. Code. Ann. § 33-31-841 (West 2016) ("Each officer has the authority and shall perform the duties set forth in the bylaws or, to the extent consistent with the bylaws, the duties and authority prescribed in a resolution of the board or by direction of an officer authorized by the board to prescribe the duties and authority of other officers.").[24] When the bylaws contain only generic descriptions of the authority of certain officers, and the corporation's board has not explicitly set forth the scope of the authority of each officer, the Court must look to the law of agency, and determine from the facts presented if the officer had the apparent authority to engage in the acts complained of. *See Fernander v. Thigpen*, 293 S.E.2d 424 (S.C. 1982);[25] *Great Am.*

[24] In Nevada, when "a person is clothed with a title such as vice president or secretary of a corporation, he has apparent authority as the agent of the corporation to act," and the authority of the officer or agent to act may only be questioned by the corporation. *Porter v. Tempa Mining & Milling Co.*, 93 P.2d 741, 744 (Nev. 1939). However, in South Carolina, the authority of a corporate officer is not inherent in his title or position. *Orphan Aid Soc'y v. Jenkins*, 362 S.E.2d 885, 887 (S.C. Ct. App. 1987).

[25] "Under the doctrine of apparent authority, a principal is bound by its agent's acts when it has placed the agent in such a position that persons of ordinary prudence, reasonably knowledgeable with business usages and customs, are led to believe the agent has certain authority and they in turn deal with the agent based on that assumption." *WDI Meredith & Co. v. American Telesis, Inc*., 597 S.E.2d 885, 887 (S.C. Ct. App. 2004); *Digital Ally, Inc. v. Z3 Tech., LLC*, 864 F. Supp. 2d 1050, 1071 (D. Kan. 2012), *aff'd in part*, 754 F.3d 802 (10th Cir. 2014) ("[a]pparent authority is 'that authority which a principal holds his agent out as possessing or permits him to exercise or to represent himself as possessing, under such circumstances as to estop the principal from denying its existence.'") (applying Nevada law).

Ins. Co. v. Gen. Builders, Inc., 934 P.2d 257, 261 (Nev. 1997). The analysis of an agent's apparent authority requires a focus on the manifestations of the principal to a third party regarding the agent's authority, as opposed to the manifestations of the agent to the third party regarding his own authority. *R & G Constr., Inc. v. Lowcountry Reg'l Transp. Auth.,* 540 S.E.2d 113, 118 (S.C. Ct. App. 2000) ("Apparent authority to do an act is created as to the third person by written or spoken words or any other conduct of the principal which, reasonably interpreted, causes the third person to believe the principal consents to have the act done on his behalf by the person purporting to act for him.") (internal citations omitted); *Name Intelligence, Inc. v. McKinnon,* 2013 WL 1793953 at *4 (D. Nev. 2013) (principal is liable for the contracts made by his agent on his behalf if the principal has held agent out to the other contracting party as having authority).

Under both South Carolina and Nevada law, agency and the authority of an agent are questions of fact. *Gathers v. Harris Teeter Supermarket, Inc.*, 317 S.E.2d 748, 752 (S.C. Ct. App. 1984); *Great American Ins. Co. v. Gen. Builders, Inc.*, 934 P.2d 257, 261 (Nev. 1997). If there are any facts giving rise to an inference of an agency relationship," then the issue is for the fact finder to decide. *Froneberger v. Smith,* 748 S.E.2d 625, 631 (S.C. Ct. App. 2013) (*citing Fernander v. Thigpen*, 293 S.E.2d at 425); *Great American Ins. Co., supra*. Furthermore, if an agent acts fraudulently against his principal, "or for any other reason has an interest in concealing his acquired knowledge from his principal," then the knowledge acquired by the agent is not imputed to the principal. *Crystal Ice,* 257 S.E.2d at 498; *Robertson v. C.O.D. Garage Co.,* 199 P. 356, 357 (Nev. 1921) ("While the law, within certain well-defined limits, will make the principal liable for frauds perpetrated in its name by the agent, it has never been

held that the principal could be made liable for the individual frauds of an agent**,** perpetrated on his own account.").

Citing to the Court's June 2013 Order for support, the MK Defendants argue that Management Defendants, implemented the Accounting Practice in the scope of their authority as officers and agents of IBG and therefore, constructive knowledge of the Accounting Practice is imputed as a matter of law to IBG. The MK Defendants direct the Court to evidence in the record that shows that the Management Defendants were responsible for the day-to-day operations of the Debtor, including the approval and issuance of financial statements and entering into contracts on behalf of the Debtor. The MK Defendants' argue that the Management Defendants' authority to issue financial statements is confirmed by the Management Representation Letters signed by certain of the Management Defendants on behalf of the Debtor.

The Trustee argues that the Management Defendants acted outside the scope of their authority when they implemented the Accounting Practice. The Trustee also argues that the sole purpose of the Accounting Practice was to fund the Management Defendants' "looting." The Trustee's position is supported by the opinion of his expert John Freeman, who opined that the Management Defendants acted outside of the scope of their agency and apparent authority, "since the underlying intent for the [transactions] was to precipitate the Management Defendants embezzlement and looting." Rule 26(a)(2)(B) Disclosure of John P. Freeman dated January 8, 2016 at 18 ("Freeman Report").

While there is evidence in the record to support the MK Defendant's contention that the Management Defendants were authorized to manage the day-to-day operations of IBG, there is also evidence in the record to support the Trustee's contention that the Management Defendants engaged in self-dealing and possibly larcenous behavior. This conflicting evidence precludes the

Court from concluding, as a matter of law, that the implementation of the Accounting Practice was within the scope of the Management Defendants' authority. In addition, construing all inferences in the Trustee's favor, if the Court accepts as true the Trustee's contention and his expert's opinion that the Accounting Practice was a fraud, the sole purpose of which was to benefit the Management Defendants at IBG's expense,[26] the Court cannot conclude as a matter of law that the Management Defendants were authorized to implement a practice, the sole purpose of which was to perpetrate a fraud on the Debtor.

In addition to the questions of fact surrounding the authority of the Management Defendants, there are also questions of material fact regarding the MK Defendant's reliance on the authority of the Management Defendants.

As the party asserting that the Management Defendants had the apparent authority to implement the Accounting Practice, the MK Defendants must show not only that IBG led them to believe that the Management Defendants had the authority to engage in the acts complained of, they must also show that their reliance on the manifestation of authority was reasonable. *See R & G Const., Inc.*, 540 S.E.2d at 118. The record contains evidence which would support a finding that certain of the Management Defendants engaged in self-dealing, in contradiction to the interests of the Debtor and its shareholders.[27] Freeman opined that the MK Defendants, "knew of or were reckless in not knowing about and/or detecting the wrongdoings of the Management Defendants, including the looting . . . [and] detrimental insider transactions . . . ."

[26] Both the MK Defendants and the Trustee discuss the issue of the Accounting Practice as a fraud. The MK Defendants maintain that the Management Defendants did not perpetrate a fraud against the Debtor but rather, if a fraud was perpetrated (which they dispute) it was a fraud for the benefit of the Debtor because implementation of the Accounting Practice benefitted the Debtor and resulted in the raising of capital that was used to fund the Debtor's operations. In contrast, the Trustee argues that the Accounting Practice was a fraud perpetrated on the Debtor that was implemented and maintained by Management Defendants to facilitate their looting. This issue is separate and apart from the issue of whether the Accounting Practice benefitted IBG, on which there is also conflicting evidence.

[27] *See infra* at IV.B.2.a.

Freeman Report at 9. Freeman also opined that "the misconduct was such that the MK Defendants had to have been aware of the wrongdoing." *Id.* at 25.

Although there are questions of fact on the issue of MK Defendants' actual knowledge of the self-dealing, resolving this inference in the Trustee's favor also raises issues of fact regarding the reasonableness of the MK Defendants' reliance on the agent's apparent authority.

For all of these reasons, the determination of the scope of authority of the Management Defendants and the constructive knowledge of the Debtor must be decided at trial.

2. Applicability of the adverse interest exception.

Even if the Court were to rule in favor of the MK Defendants on the issue of imputation, questions of fact exist as to whether or not the adverse interest exception applies, precluding summary judgment.

As discussed in the June 2013 Order, when an agent's actions are clearly adverse to his principal's, the adverse interest exception to the *in pari delicto* defense precludes imputation of the agent's actions to the principal. *Anderson v. Cordell*, 497 B.R. at 809 (internal citations omitted). As described by one court, "the adverse interest exception [is] a means of rebutting the presumption that an agent's acts are imputed to the corporation." *AMERCO Derivative Litig.*, 252 P.3d at 695, n.5; *Keenan v. Hill*, 378 S.E.2d 334 (Ga. Ct. App. 1989) (declining to impute an officer's knowledge of his own bad driving record for purposes of holding employer liable for negligent entrustment); *see also* Restatement (Third) of Agency § 5.04 (Am. Law. Inst. 2006) (if an agent takes a position adverse to his principal, then the agent is acting outside the scope of his authority, and neither his actions or his knowledge will be imputed to the principal).

As also recognized and discussed by the Court in the June 2013 Order, while most jurisdictions recognize the adverse interest exception, the extent of adversity required to prevent

imputation varies by jurisdiction. *Anderson v. Cordell*, 494 B.R. at 809 & n.8. A majority of courts, including Nevada, which governs the Court's ruling on the Trustee's Thirty-First and Thirty-Third causes of action,[28] apply the "total abandonment" standard. Under this standard, the adverse interest exception will not apply unless the agent's actions are "completely and totally adverse" to the principal. *AMERCO*, 252 P.3d at 695. As applied in Nevada, the exception is:

> very narrow [to] . . . "avoid[] ambiguity where there is a benefit to both the insider and the corporation, and reserves this most narrow of exceptions for those cases—outright theft or looting or embezzlement—where the insider's misconduct benefits only himself or a third party." If the agent's wrongdoing benefits the corporation in any way, the exception does not apply.

AMERCO, 252 P.3d at 695 (citing *Kirschner v. KPMG LLP*, 938 N.E.2d 941, 952 (N.Y. Ct. App. 2010)); *see also Zazzali*, 482 B.R. at 513 ("The adverse-interest exception is a narrow exception that applies only where the fraud is entirely adverse to the corporation's interest, such that the actor has completely abandoned the corporation's interests.").

Under Georgia law, which governs the Court's analysis of the Trustee's claims for breach of the 2008 Contract,[29] the courts take a different approach when conducting an adverse interest analysis. Georgia requires a case-by-case, fact intensive inquiry, focused on a determination of whether the agent departed from the scope of his duties and acted in such a way that the agent's private interest outweighs his obligations as a corporate representative. If it appears from the facts that the agent's private interests outweigh his obligations to the corporate principal, then under Georgia law, the agent's knowledge is not imputed to the corporation. *Cohen v. Morgan*

[28] These causes of action are Breach of Fiduciary Duty and Aiding and Abetting Breach of Fiduciary Duty.

[29] The Breach of the 2008 Contract is a portion of the Thirtieth Cause of Action.

Schiff & Co., Inc. (*In re Friedman's Inc.*), 394 B.R. 623, 632 (S.D. Ga. 2008); *Clarence L. Martin, P.C. v. Chatham Cty. Tax Comm'r,* 574 S.E.2d 407, 409 (Ga. Ct. App. 2002).

Finally, South Carolina law governs the Court's analysis of the Trustee's fraud and securities violation causes of action.[30] While South Carolina Courts have both recognized and applied the adverse interest exception, they have not ruled on the issue of the extent of the adversity required to invoke the exception. Recognizing this fact, in its June 2013 Order, this Court indicated that it believed that South Carolina would likely follow the majority and apply the more stringent "total abandonment" standard. *Anderson v. Cordell*, 497 B.R. at 812.[31]

a. Parties' arguments.

In support of their motion for summary judgment, the MK Defendants argue that regardless of the law applied, "[t]he undisputed facts show that IBG plainly benefitted from the alleged scheme, as *every witness* agrees that the capital raised pursuant to the alleged scheme funded IBG's growth and operations." MK Brief at 25 (emphasis original). The MK Defendants further argue that the Management Defendants did not misappropriate corporate assets for their own benefit or "turn IBG into their own private piggy bank," but rather their actions, "were for the benefit of [IBG]." MK Brief at 27. Thus, they argue, instead of totally abandoning the Debtor, the Management Defendants' actions enabled the Debtor to grow and thrive.

The MK Defendants' conclusion regarding the benefit to the Debtor is contradicted by the opinions of the Trustee's expert, Freeman. Rather than solely benefitting the Debtor,

[30] These are the Nineteenth and Twenty-Seventh Causes of Action.

[31] In reaching this conclusion, the Court considered several cases and found the case of *Citizens' Bank v. Heyward*, 133 S.E. 709 (S.C. 1925), to be the most recent and most persuasive indication of how the South Carolina Courts would rule. In *Citizens' Bank v. Heyward*, a bank president negotiated a loan with a customer that provided for payment of 8% interest to the bank and 2% interest to himself personally. Faced with the president's self-dealing, the South Carolina Supreme Court nonetheless ruled that the bank president acted within the scope of his agency, and imputed the president's knowledge and conduct to the bank.).

Freeman opined that the Debtor derived no benefit from the Management Defendants' actions. Freeman concluded that because of the Management Defendants' looting and embezzlement the Debtor realized "no benefit" from the approximately $4 million in cash proceeds raised pursuant to the 2006 PPM. Freeman Report at 12. Freeman also opined that IBG's funds "were utilized by the Management Defendants and diverted from [IBG] without any benefit to the Debtor," and that "[t]he only benefit of the Securities Transactions was wrongfully conferred on the Management Defendants, who used the transactions to feign the Debtor's creditworthiness . . . while they continued to divert [IBG's] assets." *Id.* at 18.

Freeman's conclusion that Management Defendants engaged in self-dealing also finds some support in the testimony of certain lay witnesses. For example, in his deposition and 2004 Exam, IBG's CFO Hargrett testified about bonuses the Cordells and Blevins received that were not authorized by the Board, and about their receipt of these bonuses and large salaries at a time when IBG could not afford to pay this type of compensation. Hargrett also testified about what he viewed as over-market rent paid by the Debtor to lease its offices from a company owned by B. Cordell, and testified about personal loans the Debtor made to B. Cordell that B. Cordell did not repay in full, and IBG's rental of a residential condominium owned by Blevins. In addition to Hargrett's testimony, Handy testified at length regarding the information he compiled from various sources regarding questionable financial transactions engaged in by some of the Management Defendants. Included in Handy's investigation is evidence that certain of the Management Defendants either sold stock in IBG and failed to remit proceeds of the same to the Debtor, or gifted stock in IBG to third parties for no consideration. There is also evidence in the record of short term loans made by Management Defendants to the Debtor that were repaid in short order with above-market interest.

b. Analysis of evidence of Abandonment under Georgia Law.

Reviewing the record as a whole, and construing the evidence in a light most favorable to the Trustee, the Court must deny so much of the MK Defendants' Motion as seeks summary judgment on the adverse interest exception under Georgia law. The record contains evidence which would support a finding that certain of the Management Defendants departed from the scope of their duties and engaged in self-dealing. There are issues of fact regarding whether the Management Defendants' self-dealing rose to a level that their private interests outweighed their obligations as corporate representatives to IBG.

Therefore, the Court must deny the MK Defendants' motion for summary judgment on the remaining portion of the Trustee's Thirtieth cause of action.

c. Analysis of evidence on Total Abandonment under Nevada Law.

Under Nevada law, for the adverse interest exception to apply, total abandonment is required. Thus, even in the face of evidence that the Management Defendants engaged in self-dealing, under Nevada law, if IBG derived any benefit from the actions of the Management Defendants, then the abandonment is not total, and the adverse interest exception does not apply. *AMERCO*, 252 P.3d at 695.

In addition to his self-dealing argument, described above, the Trustee advances the argument, which is supported by the opinions of his two experts, that the Debtor did not benefit from any of the borrowings undertaken by the Debtor from 2006 forward. *See, e.g., Beck v. Deloitte & Touche, Deloitte, Haskins & Sells, Ernest & Young, L.L.P.*, 144 F.3d 732 at 736-37 (11th Cir. 1998) (applying Florida's total abandonment standard to the adverse interest exception and finding that because the plaintiff-trustee never conceded that the debtor derived any benefitted from the defendant's actions, in either the short or long term, the court could not

conclude that the adverse interest exception applied. "A director's wrongful actions toward his corporation do not have to rise to the level of corporate 'looting' . . . or embezzlement . . . in order to be adverse and thereby prevent imputation, as long as the corporation receives no benefit from the director's misbehavior." If the agent's actions were not intended to benefit the corporation, or did not provide actual "short- or long-term benefit to the corporation," then the adverse interest exception applies).

In the present case, the Trustee does not concede that the Accounting Practice and all that flowed from it benefitted the Debtor. Instead, the Trustee argues that Debtor was not better off in either the short or long term than it would have been without the Accounting Practice, and he maintains that the Accounting Practice only benefitted the Management Defendants because it allowed them to conceal and continue their "looting."

As previously discussed, Freeman opines that the Management Defendants acted solely for their own benefit and that the only purpose of the Accounting Practice was to facilitate and fund the Management Defendants' self-dealing.

Likewise, DuRant opines that the Debtor did not benefit from the debt incurred by the Debtor as a result of the Accounting Practice. DuRant further opines that, because it incurred debt that it should not have, from the period of July 2, 2008 to the petition date, the Debtor was damaged in the amount of approximately 8.5 million dollars.[32] DuRant also opines that an alternate measure of damages can be found by looking at the Debtor's net operating losses ("NOL") for the period of July 2006 to July 2010, and that under this theory, the estate was damaged approximately $23 million.[33]

[32] Relying on figures from the claims register provided to him by the Trustee, this figure represents what DuRant says is the difference between the Debtor's debt position as of July 2, 2008, and the petition date.

[33] DuRant obtained this figure from a "Summary Report" prepared by the Trustee's consultant Ronald Burkett. Mr. Burkett's report dated April 4, 2016, concluded that the Debtor's NOL for the period of July 2, 2008 to September

Although the MK Defendants point to places in the record that call into question the validity of the Trustee's arguments and experts' opinions, for the purposes of ruling on a summary judgment motion, the Court must construe the evidence in a light most favorable to the Trustee and resolve all inferences in the Trustee's favor. Therefore, with respect to the causes of action governed by Nevada law, the Court finds that there are questions of material fact on the issue of whether the Accounting Practice and all that flowed therefrom, provided any benefit to the Debtor, precluding summary judgment on this issue.

d. Analysis of evidence on Total Abandonment under South Carolina law.

South Carolina Courts have not determined the extent of the adversity required to invoke the adverse interest exception. Although the Court believes that South Carolina would likely follow the majority (including Nevada and Delaware) and apply the more stringent "total abandonment" standard (*see Anderson v. Cordell*, 497 B.R. at 812), it is possible that courts would apply a less rigorous standard or would, as argued by the Trustee, adopt a rule that the adverse interest exception is not available as a defense to a third party who has a connection to the fraud. *See generally* Trustee's Objection at 66-67. For purposes of ruling on the Motion, the Court is not required to decide this issue. Whether the Court utilities Georgia's balancing test or the majority's total abandonment standard, as discussed herein, questions of material fact prevent the Court from ruling on the applicability of the adverse interest exception.

3. Whether the Sole Actor Doctrine Applies.

Having ruled that questions of fact prevent the Court from finding that the adverse interest exception applies, and despite the parties' failure to adequately address this issue, the

2010 was approximately 11.8 million dollars, and was approximately $23 million for the period of July 27, 2006 to July 2010.

Court will next consider whether the Management Defendants were the "sole actors" of the Debtor. If the Management Defendants were the sole actors of IBG, reliance on the fiction of imputation is not necessary, and the Management Defendants' knowledge and actions are deemed to be the knowledge and actions of IBG, entitling the MK Defendants to summary judgment as a matter of law.

The sole actor doctrine, also sometimes known as the "alter ego" or "sole representative" doctrine, is a long standing principal of agency law. Under the doctrine, if an agent "controls the principal's decisionmaking," or "clearly dominates" the principal, even if the agent's conduct is totally adverse to the principal, the agent's conduct is imputed to the principal. Restatement (Third) of Agency § 5.04 (Am. Law. Inst. 2006); *Grayson Consulting*, 716 F.3d at 368 (*citing Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*, 267 F.3d 340, 359 (3d Cir. 2001)); *AMERCO*, 252 P.3d at 695-96 (internal citations omitted).

> The rationale for this rule is that the sole agent has no one to whom he can impart his knowledge, or from whom he can conceal it, and . . . [consequently] the corporation must bear the responsibility for allowing an agent to act without accountability.

Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 359 (3d Cir. 2001); *accord AMERCO*, 252 P.3d at 695. The sole actor doctrine is not available to assist third parties who used the agent, "to further their own frauds on the principal." *Grassmueck v. Am. Shorthorn Ass'n,* 402 F.3d 833, 841 (8th Cir. 2005).

Nevada recognizes the sole actor doctrine. *See In re AMERCO Derivative Lit.*, 252 P.3d 681, 689 (Nev. 2011).[34] No South Carolina court has recognized the doctrine; however, in the

[34] When the evidence indicates that only some members of an entity's agents were engaged in questionable behavior, the presence of other "innocent decision makers," may impact the sole actor analysis. Under Nevada law, "the presence of innocent decision-makers is only relevant to assess whether there is indeed a sole actor. If some corporate decision-makers are unaware of wrongdoing then there exists no unity between the agent and the corporation such that the agent's complete adversity will impute to the corporation." *AMERCO*, 252 P.3d at 696. No South Carolina court has considered this issue. Georgia law on the innocent decision maker exception is also

appropriate circumstances, South Carolina courts will disregard the legal fiction of a corporate entity and treat the corporation and its dominant shareholders as one. *See, e.g., Oskin v. Johnson,* 735 S.E.2d 459, 465 (S.C. 2012) (discussing the elements of the alter-ego theory, which "requires a showing of (1) total domination and control of one entity by another and (2) inequitable consequences caused thereby. Control may be shown where the subservient entity manifests no separate interest of its own and functions solely to achieve the goals of the dominant entity.") (internal citations omitted); *Mid-South Mgmt. v. Sherwood Dev*., 649 S.E.2d 135, 140 (S.C. Ct. App. 2007) (in piercing cases, the court employs a two (2) part test, "The first part of the test requires an eight-factor analysis and looks to observance of the corporate formalities by the dominant shareholders [and the] second part requires that there be an element of injustice or fundamental unfairness if the acts of the corporation be not regarded as the acts of the individuals.") (internal citations omitted). Therefore, it is reasonable to presume that some form of the sole actor doctrine would be recognized in South Carolina.

As the party alleging that the Management Defendants were the sole actors of IBG, the MK Defendants have the burden of pointing to undisputed evidence in the record that shows that either that a single Management Defendant, or the Management Defendants acting in concert, controlled and dominated IBG, such that the Management Defendant(s) and IBG are one. To this end, the MK Defendants point to the testimony of Blevins, Hargrett, and Van Hoven regarding the extent and level of control exercised by the Management Defendants over the Debtor. This testimony, they say, confirms their position that the Management Defendants not only ran the day-to-day operations of the Debtor, but also were the sole actors of the Debtor.

unsettled, but the exception has been discussed by one Georgia bankruptcy court. *See In re Friedman's*, 394 B.R. 623, 632-34 (Bankr. S.D. Ga. 2008).

There is no allegation and no evidence in the record that any one of the Management Defendants, acting alone, was the sole actor of the Debtor. And, while there is evidence that the Management Defendants, both individually and collectively, wielded power within IBG, the MK Defendants have failed to point to sufficient undisputed evidence in the record to convince the Court that, as matter of law, IBG and the Management Defendants should be treated as one.

In addition, because the sole actor doctrine cannot be invoked by third parties who used the corporate agent to further their own frauds on the principal, the Court cannot grant the MK Defendants summary judgment on the sole actor doctrine if there are material questions of fact on the issue of whether or not the MK Defendants perpetrated a fraud on IBG. Specifically, The Trustee alleges that the MK Defendants perpetrated a fraud on the Debtor when they failed to disclose to the Debtor the Management Defendants' self-dealing and implementation of the Accounting Practice.[35] In support of these allegations, the Trustee points to evidence in the record that he contends shows that the MK Defendants facilitated the Management Defendants' fraud and looting, and continued in its efforts to coordinate loan transactions and find investors for the Debtor, presumably for the purpose of receiving a commission.

The Trustee's claims regarding the MK Defendants' fraud against the Debtor find support in the opinions contained in Freeman's Second Supplemental Rule 26(a)(2)(B) Disclosure dated February 22, 2016 ("Freeman Second Supplemental Report"). In his Second Supplemental Report, Freeman opines that the MK Defendants, "counseled the Management Defendants to use a strategy calculated to mislead other members of Debtor's Management and board [in contravention] of accepted standards of professionalism and business conduct." Freeman Second

[35] *See, e.g,* Trustee's Memorandum at 41, "MK used the fraudulent financial figures in preparing [the 2006 CIM which] contained materially misleading statements and material omissions and was directed by the MK Defendants towards . . . demonstrating to the Innocent directors that procuring [certain] investments was in the Debtor's best interest."

Supplemental Report at 2. Freeman also opines that the MK Defendants served "the interests of the Management Defendants instead of the interests of the Debtor, [their] actual client," in part by continuing "to vouch in favor of Debtor's fatally flawed accounting." *Id.* at 2-4. In the Freeman Report, Freeman opined the MK Defendants, "assisted the Management Defendants in defrauding the Innocent Directors by working with Management Defendants to refine and sculpt versions of the [Grafton Financials] to conceal the fraudulent accounting and to conceal the Debtor's losses and portray a false image of the Debtor's financial health in order to make it easier [to generate investments]." Freeman Report at 8-9 Freeman and DuRant further opined that these and other actions ultimately resulted in the Debtor's downfall. *See, e.g.*, Freeman Report at 17 and 27.

In light of the insufficient evidence on the issue of whether the Management Defendants were IBG's sole actor, and the evidence and expert opinion on the issue of whether the MK Defendants perpetrated a fraud on IBG, the Court must deny the MK Defendants' Motion on the applicability of the sole actor doctrine.

CONCLUSION

Reviewing the record as a whole, and construing the evidence in a light most favorable to the Trustee, the Court finds that several questions of material fact exist that preclude an award of summary judgment the MK Defendants on the affirmative defense of *in pari delicto*. Therefore, for the reasons cited herein, it is,

ORDERED that the MK Defendants' Motion for summary judgment on the Trustee's claim for breach of the 2006 Contract is GRANTED; it is further,

ORDERED that the MK Defendants' Motion for summary judgment on the Trustee's claim for unjust enrichment is GRANTED. It is further,

ORDERED that the MK Defendants' motion for summary judgment on the remainder of the Trustee's claims is DENIED. It is further,

ORDERED that the further pre-trial conference in this matter is set for **January 24, 2017, at 9:30 a.m.** in Columbia, SC.

AND IT IS SO ORDERED.